11 U.S.C. § 1112(b)

Potter v Double T. Farming Case No. 694-61950-psh11
Civ . Case. No. 96-1300-RE

1/3/97 Judge Redden. Affirming PSH

Judge Redden affirmed the bankruptcy court's order dismissing the debtor's Chapter 11 filing and denying the debtor's motion to convert on tthe grounds that the case was filed in bad faith. The court found that the debtor had no ongoing business or employees to protect and no realistic hope of reorganization and that it filed its Chapter 11 petition solely to avoid paying a supersedeas bond on appeal of a state court judgment. It concluded, therefore, that the petition had been filed in bad faith. Judge Redden affirmed noting where the debtor has no realistic hope of reorganization and uses a bankruptcy filing as a litigation tactic to avoid paying a supersedeas bond in a state court action the court may dismiss the petition on the grounds that it was filed in bad faith.

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

LYNN D. POTTER, et al.,

Plaintiffs,

v.

DOUBLE T FARMING, an Oregon corporation, et al.,

Defendants.

Civil No. 96-1300-RE

OPINION

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REDDEN, Judge:

This case comes before this court because the debtors have appealed Judge Higdon's rulings. The debtor's are claiming:

1. Judge Higdon erred in denying the debtor's motion to convert their case from one under Chapter 13 to one under Chapter 11 of the Bankruptcy Code.

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2. The court erred when it dismissed the debtor's case on the ground that the debtor's debts exceed the monetary limits ($250,000) of 11 U.S.C. § 109(e).

Specifically, the debtors allege five findings of fact made by Judge Higdon are clearly erroneous. They also allege several conclusions of law are wrong. Each finding and conclusion will be discussed below.

The Court finds the bankruptcy court did not err in denying to convert the debtor's case from Chapter 13. The Court also finds the bankruptcy court was correct in dismissing the case on the grounds that the debtor's debts exceed the monetary limits of Chapter 13.

Background

The case was originally filled as a Chapter 13 on May 31st, 1995. Debtor's schedule revealed assets consisting of a home, valued at $140,000, household goods, two vehicles, some equipment, an insurance policy and a receivable, all valued at $38,924. In addition the debtors listed as an asset an interest in Potter & Sons partnership and PT Development partnership with unknown values. PT Partnership is a general partnership whose partners are the debtors and Double T Farming, a general partnership. The Double T Farming partners are Paul Taylor (a creditor and appellee) and Rodrick Taylor. The PT Development partnership is the subject of state court litigation between the debtors and one of the creditors. Currently, the creditor/appellee as two judgments in his favor against the debtors totaling $395,000. The debtors claim they are appealing these judgments.

The debtors also have a multitude of liens against their residence that combined, exceed the listed value of the house. In addition, the debtors owe around $24,000 priority taxes to the state and federal government and have scheduled $458,190 of general unsecured indebtedness. Of this, the appellee's (Paul Taylor) judgments are scheduled at $395,000.

On October 23rd, 1995, creditor Paul Taylor filed a motion to dismiss the case based on 11 U.S.C. § 109(e), because the debtors exceeded the statutory ceilings for Chapter 13 ($250,000). On December 27th, 1995, the court found that the debtors were not eligible for

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Chapter 13 in that their unsecured noncontingent liquidated debt exceed $250,000. At that time, Judge Higdon gave the debtors a short time to convert their case to Chapter 11.

On January 2nd, 1996, the debtors filed a motion to convert their case to Chapter 11. At the hearing on the motion to convert the debtors argued they had filed their bankruptcy case for three reasons: (1) halt foreclosure against their home by the IRS, (2) attempt to set aside as preferential the state court judgments entered against them in favor of Paul Taylor (creditor/appellee), and (3) to stay execution on the state court judgments while avoiding the posting of a supersedeas bond while appealing those judgments.

In determining whether to grant the motion to convert, the court considered the same facts as if the debtors had filed the Chapter 11 and the creditor had then filed a motion to dismiss. The court noted that 11 U.S.C. § 1112(b) allows the court to dismiss a Chapter 11 proceeding for cause. The court went on to recognize that the Ninth Circuit includes a finding of lack of good faith within the definition of cause. In re Marsh, 36 F3d 825 (9th Cir 1994).

The court cited Marsh for the concept that lack of good faith includes filing for a variety of tactical reasons unrelated to reorganization. Id. at 828. Judge Higdon noted that such a tactical reason may include filing a Chapter 11 to stay a state court judgment against the debtor pending appeal. The Marsh decision does not address or consider this specific issue, but notes that some courts have found such a filing to be made in bad faith. Id. at 828.

The court found that the sole purpose for the debtors to file bankruptcy was to avoid the posting of a supersedeas bond in their state court appeal and to attempt to use the strong-arm powers in bankruptcy to overturn the state court judgments. Judge Higdon found this bad faith on the part of the debtors. The court reasoned that "among the factors [it] must weigh when the debtor's primary purpose for a Chapter 11 is to avoid the posting of the supersedeas bond is that the creditor has a right under state law to financial protection during any appeal absent a waiver by the state court. Further, one of the purposes for the bond is to act as a distinct disincentive to abusive appeals. The filing of a Chapter 11 as a substitute for the bond removes that disincentive." Judge Higdon's March 8, 1996 ruling. For this reason, the court denied the debtor's motion to convert.

Standards

In reviewing a bankruptcy court decision, this court acts as an appellate tribunal, and is governed by traditional standards of appellate review. Factual findings are reviewed under the clearly erroneous standard, and conclusions of law are reviewed *de novo*. Ragsdale v. Haller, 780 F.2d 794, 795 (9th Cir. 1986). The lower court's findings of fact must be accepted unless the appellate court is left with the definite and firm conviction that a mistake has been made. United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948). Conclusions of law and mixed questions of law and fact are reviewed *de novo*. In re Hedgecock, 160 B.R. 380 (D. Or. 1993).

De novo review requires consideration of the matter anew, as if it had neither been heard before nor a decision been previously rendered. United States v. Silverman, 861 F.2d 571, 576 (9th Cir. 1988).

The finding of "bad faith" in the context of dismissing a Chapter 11 Bankruptcy petition for cause is reviewed for clear error. In re Eisen, 14 F3d 469, 470 (9th Cir. 1994).

Discussion

The debtors argue that the court erred by denying debtors' motion to convert on the grounds that their petition was filed in bad faith. The debtors claim this decision is reversible because the court relied on erroneous findings of facts and conclusions of law. Each of these alleged errors is addressed below.

The debtors argue the most important question raised by the court's decision is "whether the specific cause for dismissal cited by the court is, as a matter of law, within the contemplation of the applicable statute." Appellant's Opening Brief, p. 9. Specifically, the debtors argue that even assuming the court's finding of fact that the debtors' sole reason for filing their petition was to avoid posting a supersedeas bond was true, that finding is not legally sufficient to support a finding of bad faith.

A bankruptcy judge may, as a matter of law, dismiss a Chapter 11 bankruptcy if the debtor is proceeding in bad faith. In re Marsh 36 F3d 825 (9th Cir. 1994) "In determining whether debtor's filing for Chapter 11 relief is in good faith depends largely upon the

bankruptcy court's on-the-spot evaluation of the debtor's financial condition, motives, and the local financial realities. Matter of Little Creek Development Co., 779 F2d 1068 at 1072 (5th Cir. 1986).

"One limitation some courts have implied under section 1112(b) involves Chapter 11 cases filed to stay a state court judgment against a debtor pending appeal. In those cases, courts have expressed concern that the petition is merely a "litigating tactic" designed to 'act as a substitute for a supersedeas bond' required under state law to stay the judgment." Marsh at 828 citing In re Wally Findlay Galleries, 36 B.R. 849, 851 (Bankr.S.D.N.Y.1984).

The Ninth Circuit has not considered the issue of whether filing a Chapter 11 for the *sole* purpose of avoiding posting an appeal bond allows a court to find the petition was filed in bad faith. The closest case on point is In re Marsh, 36 F3d 825 (9th Cir. 1994). In Marsh, the bankruptcy court dismissed a debtor's case because it found that debtor's petition was filed solely to delay collection of the restitution judgment and to avoid posting an appeal bond. Id. at 829. Most importantly, the bankruptcy court noted that the debtor *had* the financial means to pay the judgment and the judgment did not pose any danger of disrupting business interests - thus the bad faith. Based on these factual findings, the Ninth Circuit held the dismissal of the debtor's Chapter 11 petition was proper.

In the case at hand, Judge Higdon noted that the debtor's had no ongoing business, even potentially viable, which would be disrupted by execution on the state court judgments. Thus, using the reasoning in Marsh and assuming the finding of fact that debtor's filed their petition solely to evade the requirement of posting an appeal bond was not clear error. It is proper, following the logic in Marsh, to find the debtor's had filed their petition in bad faith.

In this case, the debtor argues that because they did not have the ability to post a bond or pay a judgment, Marsh requires the opposite result. The debtor's cite Matter of Little Creek Development Co., 779 F2d 1068 at 1072 (5th Cir. 1986) for the proposition that a petition so filed is not, by itself, sufficient grounds to support a dismissal for bad faith.

There the court noted that the totality of the circumstances must be examined, and noted that, several but not all of the following conditions usually exist for a finding of bad faith:

(1) the debtor has one asset such as a piece of land, (2) the secured creditor's liens encumber the land, (3) there are generally no employees except the principals, (4) little or no cash flow, and no available sources of cash flow to sustain a plan of reorganization, (5) the debtor and creditor have proceeded to a stand-still in state court litigation, and the debtor has lost or has been required to post a bond which it cannot afford. Id. at 1072-1073. The court goes on to state that "[resort to the protection of the bankruptcy laws is not proper under these circumstances [referring to the conditions cited above] because there is no going concern to preserve, there are no employees to protect, and there is no hope of rehabilitation, except according to the debtor's terminal euphoria. Id. at 1073. The bankruptcy court there made insufficient findings of fact and remanded the case for further findings.

The above analysis supports Judge Higdon's findings of fact that the debtors filed their petition in bad faith. The debtors have no employees, little or no cash flow and no available sources of income to sustain a plan of reorganization or to make adequate protection payments. Additionally, the debtor cannot afford to post the required appeal bond.

A. Findings of Facts

1. Number 11. The debtor claims there was no evidence to support the finding that debtors failed to show how long its appeal of the state court litigation would take or, assuming the debtors were successful in their appeal, how much money would be available for a Chapter 11 liquidating plan. I agree with the bankruptcy court's findings. There is no clear error.

2. Number 16. Judge Higdon found that inside or outside of bankruptcy, the debtors will lose their residence, by foreclosure or through sale, and no fund will be generated from the residence to apply to any unsecured debt. The debtor claims this finding of fact "is not accurate because it is too limited." This court has reviewed the record and find substantial evidence to support this finding. There is no clear error.

3. Number 17. The debtor claims that there was no evidence to support Judge Higdon's finding that the debtors "presently do not have sufficient income or assets to support a Chapter 11 plan which would have a reasonable opportunity of confirmation within a

reasonable period of time, nor will they in the foreseeable future." Judge Higdon had before her all of the debtors schedules listing debtors' assets, income and obligations. She also had debtors' proposal to pay $214 per month on the obligations until resolution of the state court appeal. Judge Higdon, using the facts before her and her experience, reached a conclusion in her finding. There is no clear error.

4. Number 18. Using her discretion and the evidence before her, Judge Higdon found that the sole purpose for the debtors to file bankruptcy was to avoid the posting of a supersedeas bond in their state court appeal. The evidence presented supports this finding. There is no clear error.

5. Number 19. Judge Higdon found the debtors have no ongoing business, even potentially viable, which would be disrupted by execution on the state court judgments. She went on to find that the debtors had not identified to the court's satisfaction any assets other than wages which, absent Chapter 11, the judgment creditor could execute against. This finding is supported by the record. There is no clear error.

B. Judge Higdon's Conclusions of Law

1. Number 5. While it is true the bankruptcy court did refer to the wrong cite when concluding an appeal bond was required, the fact remains that a bond was required to be filed. The substance of ORS 19.040 and ORS 53.040 is the same with respect that to the appeal bond filing requirement. To reverse simply because the court cited the wrong statute even though application of both statutes is the same would be to put form over substance. The debtor cited no case law that supported their position on this issue. Judge Higdon's ruling was correct.

2. Number 8(4). Judge Higdon is experienced in determining whether Chapter 11 plans are confirmable. It is clear from the record that until the appeal was resolved, confirmation of a Chapter 11 plan would be impossible. Thus, I believe Judge Higdon's ruling was correct.

3. Dismissing the Chapter 13 case. Debtors argue that the two judgments against them are contingent and unliquidated - thus the threshold amount of debt is below the

$250,000 limit. Generally, judgments represent non-contingent, liquidated obligations. In re Albano, 55 BR 363, 369 (ND Il 1985); In re Cluett, 90 BR 505, 507 (Bankr MD Fl (1988). The debtors argue that the judgments are unliquidated because it uncertain how much will have to be paid after the partnership assets (owned by debtor and creditor) are paid towards the claim. While it is true the partnership is a judgment debtor, the creditor correctly notes that ORCP 67E(1) provides a judgment in an action against a partnership may be entered against the partnership and shall bind the joint property of all partners. Section E(2) specifically provides in an action against parties jointly indebted (as is the case in one of the two judgments) on a joint obligation, contract or liability, a judgment may be taken against fewer than all parties obligated. Therefore, the judgment can be considered liquidated.

Conclusion

Because no clear errors of findings of fact and no errors of law were made, this Court affirms the Bankruptcy Court's ruling in this matter.

Dated this 1st day of November, 1996.

James A. Redden
United States District Judge